

Research Rural Wrap

7 June 2024

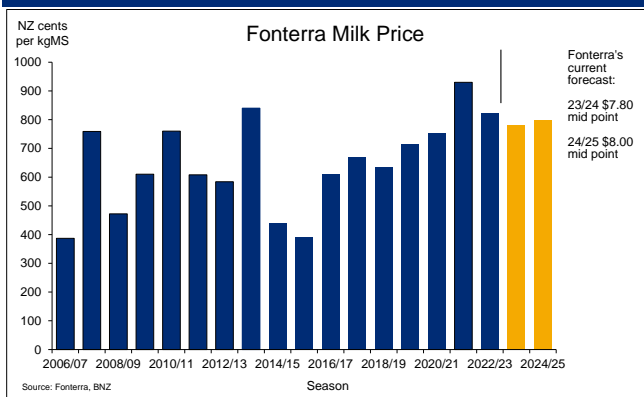
Forecasts and Outcomes

- **Fonterra takes ‘cautious approach’**
- **Milk price outcomes have differed from forecasts**
- **Historical milk price forecast miss average near zero**
- **Market thinks above \$8 for milk price this season**

Fonterra put a wide, but realistic, range on its opening 2024/25 milk price forecast. The \$8.00 midpoint came along with a range of \$7.25 to \$8.75 attached.

The new season midpoint forecast is higher than the current \$7.80 forecast for the 2023/24 season. But it is lower than some might have expected. The SGX-NZX futures pricing for the 2024/25 season has been hovering around the \$8.50 mark recently. That said, the latter is market pricing for the actual outcome not a forecast of Fonterra’s forecast.

Fonterra \$8 forecast looks cautious



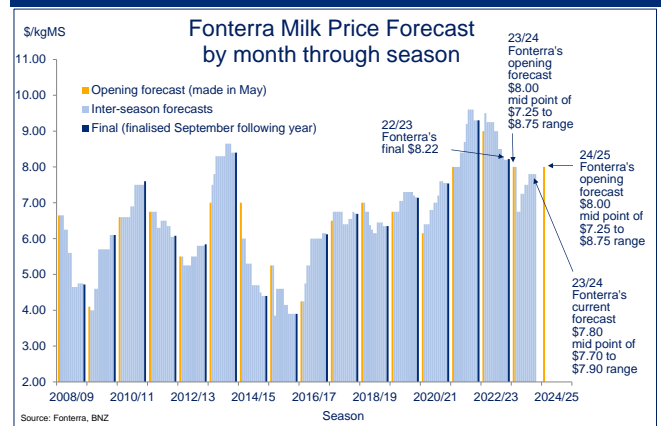
Fonterra’s new season milk price forecast seems consistent (on our calculations) with softer-than-current GDT prices on average over the season ahead. An \$8 milk price would be close to, but a touch under, average on an inflation-adjusted basis.

Fonterra’s forecast looks cautious. In fact, it says so itself. The co-op noted that ‘given the early point in the season, the uncertainty in the outlook and ongoing risk of volatility in global markets, we are starting the season with a cautious approach’.

That seems a fair view. Indeed, our own 2024/25 milk price forecast, that has remained unchanged for months at \$8.20, could be seen as a bit conservative too given it also factors in lower GDT prices on average over the season ahead compared to current levels.

Labels like cautious or conservative might give some a feeling that upward adjustment is more likely through the season than downward adjustment. That might turn out to be the case, all going well. We will happily revise up our own forecast if developments suggest this is appropriate. But the opposite is also possible. That is the very nature of uncertainty and risk. We have certainly seen plenty of forecast adjustments in previous seasons and this one is mostly likely to be no different.

Same opening as last year, but dynamics different



This begs the question whether milk price forecasts at the beginning of the season are so cautious that they tend to underestimate the actual outcome? Or, more generally, how does the actual milk price outcome compare to Fonterra’s first forecast for the season?

To get a feel for this we have had a quick look over the past 10 seasons and compared the final milk price result with Fonterra’s first forecast. The following chart shows the difference between those two figures. We have assumed the 2023/24 milk price finalises at \$7.80. Some observations are:

- The average milk price forecast error over the past 10 years has been close to zero.
- The number of overshoots has equalled the number of undershoots (at 5 apiece).
- There have been some very large misses.

Milk price forecasts are not always accurate – a fact that should surprise no one and demonstrated by some very large surprises on occasion. For example, in 2016/17 when the final milk price came in at \$6.12, a full \$1.87 higher

than Fonterra's first forecast of \$4.25. Or in 2014/15 when the milk price finished at \$4.40, which was a whopping \$2.60 below the initial forecast of \$7.00 forecast. Other milk price forecasters have no doubt seen similarly large surprises over time too.

If nothing else this highlights the inherent difficulty in forecasting – more than 12 months ahead – something that depends on many, and highly volatile, components like commodity prices, currency fluctuations, weather conditions, and costs.

Despite some very large misses, the forecast errors average close to zero. This is consistent with no forecast bias over time. The unders and overs have tended to balance out over time.

Does this give any guidance for the season ahead? To be frank, it is difficult to know whether the 2024/25 milk price will end up higher or lower than \$8.00 (or our \$8.20 forecast for that matter). The significant variability and average forecast miss over time would suggest a roughly equal chance of either.

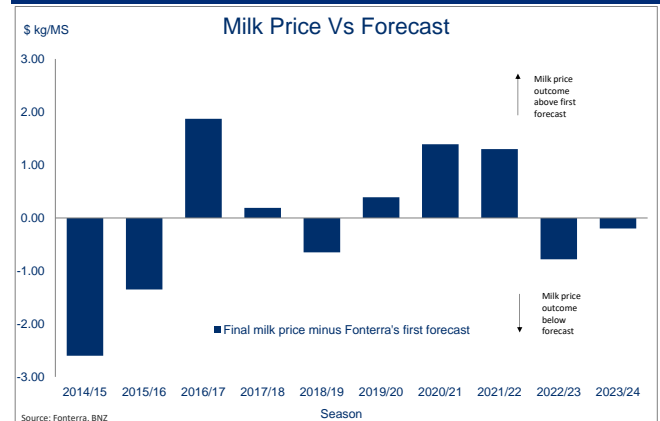
That said, eyeballing the chart of milk price surprises one might see a hint of a cycle about them. If that is indeed the case, following a couple of seasons where milk price outcomes have undershot initial forecasts, it's tempting to think an overshoot this season is a better than an even chance. Of course, there is no guarantee of that. But it is how the futures market currently prices things and is implicit in our own point forecast. Only time will tell if that is how it plays out.

Historical patterns are one thing, what happens next is another. In six out of the past ten seasons, milk price

outcomes have differed from initial forecasts by more than 75c. That is six out of the past ten seasons that have had a result outside the width of the range that has been attached to this season's forecast midpoint. Shocks can, and do, happen. Accurately forecasting milk price is just plain difficult. That, on its own, might counsel a degree of caution.

In the end, what matters most is what happens, not what is forecast. So it is back to watching the regular GDT auctions, fluctuations in the NZD, and everything else that influences milk price.

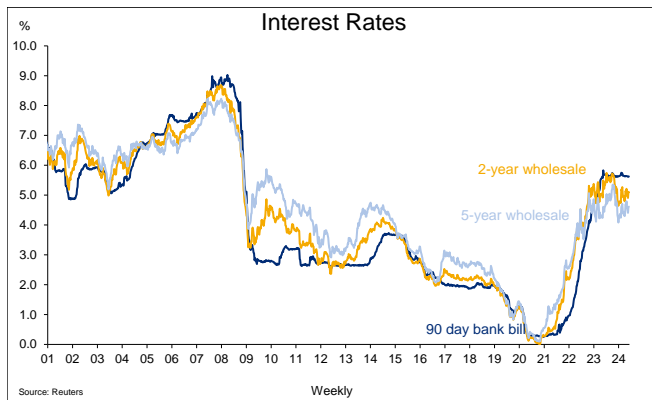
Difference between milk price outcome and first forecast



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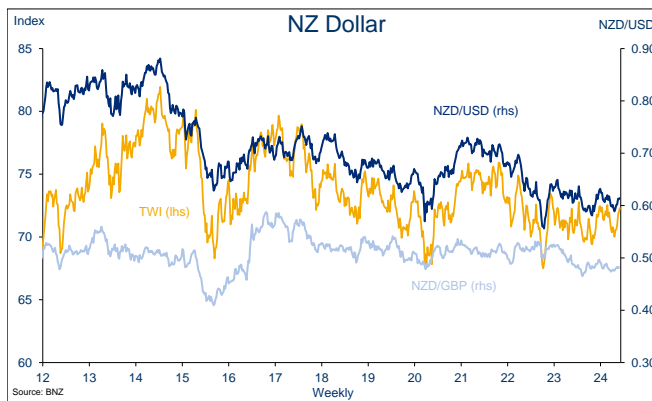
Key Macro Drivers for Commodity Producers

Interest Rates



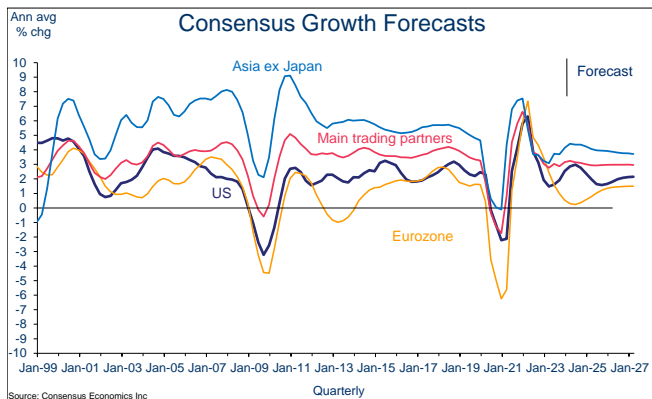
The Reserve Bank left the OCR at 5.50% at its May meeting, as was unanimously expected. However, the Bank’s tone was unequivocally hawkish. Not only did the RBNZ lift its projected rate track a little, but it also said the committee contemplated raising rates on the day. The Bank put more emphasis on the sticky domestic inflation pressures than the economic recessionary conditions. Recognising the firm RBNZ messaging, our forecasts don’t see the first OCR reduction until early next year. We continue to think that 5.5% will mark the peak OCR level for the cycle. We think that, on balance, the fiscal position will make the RBNZ more nervous. The OCR outlook depends on inflation and the RBNZ having confidence that it will be sustained near 2%. Market pricing is broadly consistent with a cut by year end and further reductions next year. Offshore, some major central banks have started lowering rates, including the ECB. The Fed continues to suggest its next rate move is down, but timing requires more inflation-friendly data.

Foreign Exchange



The NZD has pushed a bit higher. Supporting the move has been broad-based USD weakness, higher risk appetite, rising global growth forecasts, and a more hawkish than the market expected RBNZ. Despite the strong bounce, the NZD/USD remains very cheap on our fundamental model. Market pricing of only modest Fed rate cuts provides room for further NZD upside. Pricing for US interest rates remains a key driver of NZD direction. We have no strong directional view on NZD/GBP or NZD/EUR. The NZD/JPY has pushed into the mid-90s. Despite intervening in the FX market to support the Yen, the Bank of Japan is dovish, seeing the Yen unloved by markets. Ultimately, we see NZD/JPY heading lower but timing remains elusive.

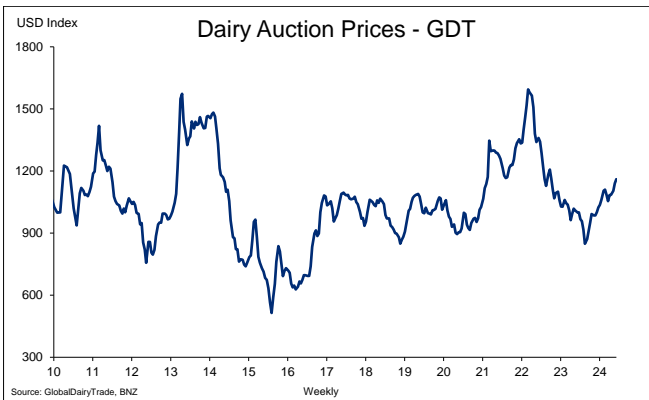
Global Growth



Global economic growth forecasts are getting revised a bit higher. It has helped some primary product prices lift off their lows. But global growth expectations remain below average, so we remain cautious on extension of the recent lift in some commodity export prices. Some stickiness in inflation has reduced the likelihood of rapid policy rate cuts by major central banks this year, but inflation progress has been sufficient to see some central banks begin to reduce the degree of restrictive policy. More policy easing than expected presents some upside risk to primary product prices. Global equity markets hitting record highs are encouraging. However, geopolitical risks remain elevated and could alter global economic conditions abruptly. Shipping cost indicators have pushed higher.

Key Commodities

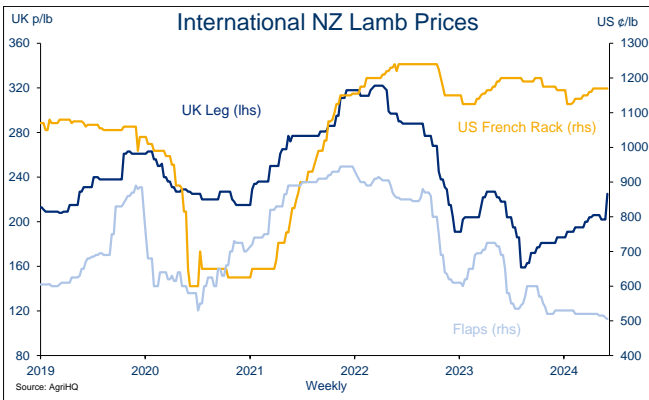
Dairy



The new dairy season has kicked off with a lift in GDT prices. The 1.7% gain might not look that much but prices often ease at this time of year so is arguably a bit better than it looked. Prices are 16% above year earlier levels. But demand has looked strongest for near term product, with forward pricing into the heart of the NZ season a bit lower. Fonterra’s first milk price forecast for 2024/25 had a \$8 midpoint. This looks like it builds in softer-than-current GDT pricing on average over the season. Our own milk price forecast for 2024/25 remains at \$8.20. It is early days. If GDT prices don’t moderate, a higher milk price is likely.

	Current	Month ago	Year ago	Next 12 months
Whole milk powder (US \$/t)	3480	3440	3140	↓

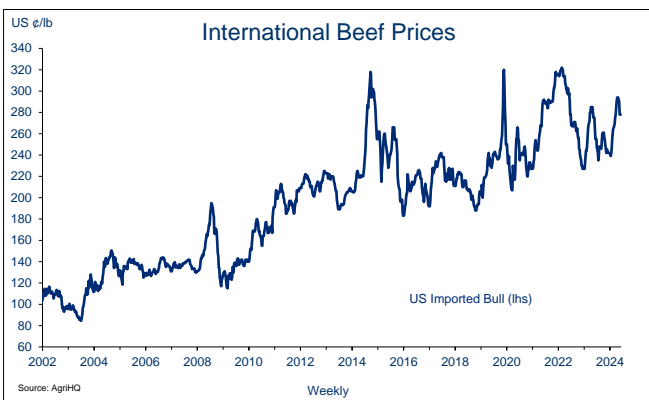
Lamb



International lamb price movements have varied by market but remain very challenging overall. Demand improvement in the likes of the UK has seen extension of recent price gains there. But it is the opposite in China with pricing low. Ongoing huge supply from Australia is expected to remain a significant headwind to prices (although the possibility of La Nina conditions ahead has the potential to suppress the flow somewhat). Locally, this season’s lamb prices are tracking at their lowest inflation-adjusted level since 2008. Even with some improvement, average prices are expected to remain below historical norms next season.

	Current	Month ago	Year ago	Next 12 months
Lamb leg (UK p/lb)	225	206	218	↑

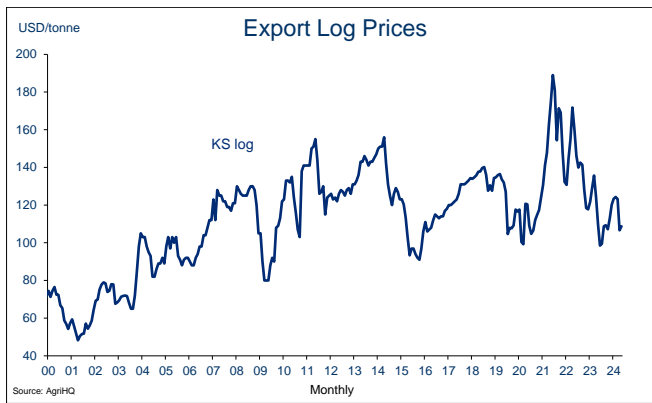
Beef



US beef prices have pulled back from recent highs. While US supply has remained constrained, more product from the likes of Australia, NZ, and South America has seen some downward price pressure. Beef demand from China is reportedly stable, with ongoing strong supply especially from South America keeping prices in check. Strong supply is expected to persist out of Australia and Brazil, but some tightening elsewhere including in the US and growing demand is expected to support prices. Locally, pricing is near its highs for this time of year, but still under on an inflation-adjusted basis. We see next season’s average beef prices a touch higher than the current season.

	Current	Month ago	Year ago	Next 12 months
Imported bull (US e/lb)	278	291	264	→

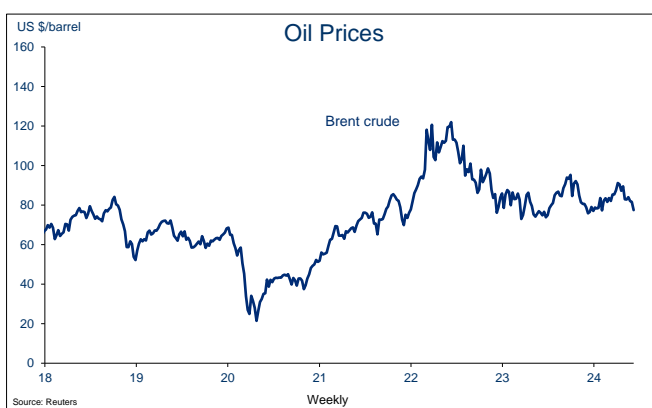
Forestry



Export log prices remain weak with subdued economic conditions in China. AgriHQ reports stocks that had built up on Chinese ports have started to retreat. But higher shipping costs and NZD have been offsetting factors on the price front. NZ log export prices continue to track well below historical norms on an inflation-adjusted basis. Domestically, the prolonged drop in residential building consents is showing some signs of ending but construction activity itself is expected to fall further this year. However, prices have largely held steady, supported by responses on the supply side.

	Current	Month ago	Year ago	Next 12 months
S1/S2 log price (NZ \$/t)	128	129	132	➔

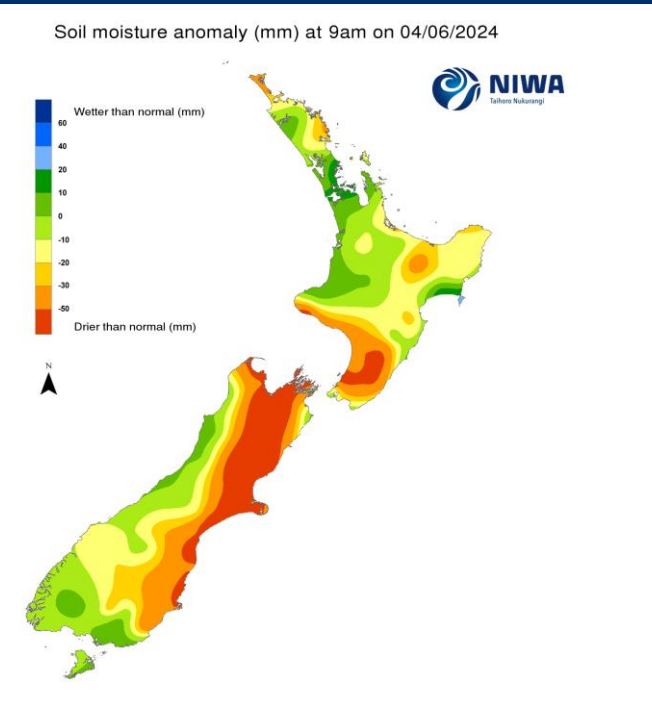
Oil



After peaking above \$US90/bbl in April, Brent crude oil prices have been generally tracked lower on ample supply. Prices took another leg lower recently, dipping to around \$US80/bbl after OPEC+'s surprise decision to return oil supply to the market in October as it looks to phase out earlier production curbs. The combination of lower global crude prices and a firmer NZD has seen some downward adjustment in domestic fuel prices. The oil futures curve is mildly downward sloping, adding to the notion prices are likely to remain subdued, barring shocks.

	Current	Month ago	Year ago	Next 12 months
Brent Crude (US \$/b)	79	83	76	➔

Weather



Soil moisture maps show a significant strip of the country is not only very dry, but significantly drier than normal, although other parts of the country are closer to normal. The El Niño weather pattern has ended but its consequences remain. It adds to cost and is detrimental to output. Little respite seems likely in the near term for the dry areas, with NIWA forecasts showing soil moisture levels are most likely to be below normal in the north and east of the South Island, near normal in the west of both islands, and equally likely to be near normal or below normal in the north and east of the North Island. Disconcertingly, NIWA note that soil moisture deficits such as in the lower North Island and South Island will continue to be slow to be alleviated. Further ahead, climate models show a 60-70% chance of La Niña conditions developing during spring. La Niña's tend to bring more Northeasterly winds and wetter conditions to the northeastern areas of the North Island and less rainfall to the lower and western South Island. Important to watch for primary producers, but also for electricity generation especially with hydro lakes levels already on the low side.

Quarterly Forecasts

Forecasts as at 7 June 2024

Key Economic Forecasts

Quarterly % change unless otherwise specified

Forecasts

	Sep-23	Dec-23	Mar-24	Jun-24	Sep-24	Dec-24	Mar-25	Jun-25	Sep-25	Dec-25
GDP (production s.a.)	-0.3	-0.1	-0.1	0.0	0.5	0.6	0.7	0.7	0.8	0.8
Retail trade (real s.a.)	-0.8	-1.8	0.5	-0.5	0.4	0.5	0.8	1.0	1.2	1.1
Current account (ytd, % GDP)	-7.4	-6.9	-6.6	-6.6	-6.3	-5.7	-5.1	-4.8	-4.7	-4.5
CPI (q/q)	1.8	0.5	0.6	0.6	0.9	0.5	0.5	0.6	0.8	0.0
Employment	0.0	0.4	-0.2	0.0	0.1	0.2	0.3	0.5	0.6	0.7
Unemployment rate %	3.9	4.0	4.3	4.7	5.1	5.3	5.5	5.5	5.5	5.3
Avg hourly earnings (ann %)	7.1	6.6	4.8	4.1	3.0	3.3	3.9	3.4	3.2	3.0
Trading partner GDP (ann %)	3.1	3.3	3.2	3.1	2.9	2.9	2.9	3.0	3.0	2.9
CPI (y/y)	5.6	4.7	4.0	3.6	2.7	2.7	2.6	2.6	2.5	2.0
GDP (production s.a., y/y)	-0.6	-0.3	0.0	-0.5	0.3	0.9	1.7	2.5	2.8	3.0

Interest Rates

Historical data - qtr average

Forecast data - end quarter

	Cash	Government Stock			Swaps			US Rates		Spread NZ-US Ten year
		90 Day	5 Year	10 Year	2 Year	5 Year	10 Year	Libor 3 month	US 10 yr	
2022 Sep	2.83	3.33	3.65	3.77	4.12	3.95	3.95	3.00	3.10	0.67
Dec	4.00	4.27	4.34	4.31	5.10	4.67	4.55	4.50	3.80	0.49
2023 Mar	4.58	4.99	4.27	4.26	5.11	4.51	4.40	4.90	3.65	0.61
Jun	5.42	5.62	4.23	4.27	5.19	4.44	4.30	5.40	3.60	0.68
Sep	5.50	5.66	4.87	4.87	5.54	4.90	4.75	5.65	4.15	0.73
Dec	5.50	5.63	4.48	4.67	4.93	4.43	4.50	5.65	4.00	0.67
2024 Mar	5.50	5.64	4.41	4.64	4.91	4.38	4.40	5.60	4.20	0.44
Forecasts										
Jun	5.50	5.65	4.65	4.90	4.75	4.70	4.70	5.75	4.50	0.40
Sep	5.50	5.65	4.50	4.75	4.40	4.55	4.65	5.50	4.25	0.50
Dec	5.50	5.50	4.25	4.60	3.95	4.30	4.50	5.25	4.10	0.50
2025 Mar	5.25	5.00	4.15	4.60	3.60	4.20	4.60	4.75	4.00	0.60
Jun	4.75	4.50	4.00	4.50	3.35	4.05	4.50	4.50	3.90	0.60
Sep	4.25	4.00	3.90	4.40	3.25	3.95	4.40	4.25	3.80	0.60
Dec	3.75	3.75	3.85	4.35	3.25	3.90	4.35	4.00	3.75	0.60

Exchange Rates (End Period)

USD Forecasts

	NZD/USD	AUD/USD	EUR/USD	GBP/USD	USD/JPY
Current	0.62	0.67	1.09	1.28	156
Jun-24	0.60	0.65	1.07	1.25	150
Sep-24	0.61	0.67	1.09	1.28	146
Dec-24	0.62	0.69	1.11	1.30	143
Mar-25	0.64	0.71	1.13	1.31	140
Jun-25	0.65	0.72	1.14	1.32	137
Sep-25	0.66	0.74	1.16	1.34	134
Dec-25	0.67	0.75	1.17	1.35	131
Mar-26	0.66	0.74	1.18	1.36	129
Jun-26	0.65	0.73	1.18	1.36	129

NZD Forecasts

	NZD/USD	NZD/AUD	NZD/EUR	NZD/GBP	NZD/JPY	TWI-17
Current	0.62	0.93	0.57	0.48	96.5	72.9
Jun-24	0.60	0.92	0.56	0.48	90.0	70.9
Sep-24	0.61	0.91	0.56	0.48	89.1	71.2
Dec-24	0.62	0.90	0.56	0.48	88.7	71.5
Mar-25	0.64	0.90	0.56	0.49	88.9	72.4
Jun-25	0.65	0.90	0.57	0.49	89.1	73.3
Sep-25	0.66	0.89	0.57	0.49	88.4	73.4
Dec-25	0.67	0.89	0.57	0.50	87.8	74.0
Mar-26	0.66	0.89	0.56	0.49	85.1	73.1
Jun-26	0.65	0.89	0.55	0.48	83.9	72.4

TWI Weights

14.5% 17.7% 9.5% 3.4% 5.6%

Source for all tables: Statistics NZ, Bloomberg, Reuters, RBNZ, BNZ

Annual Forecasts

Forecasts as at 7 June 2024	March Years					December Years				
	Actuals		Forecasts			Actuals				
	2022	2023	2024	2025	2026	2021	2022	2023	2024	2025
GDP - annual average % change										
Private Consumption	6.0	2.7	0.1	0.7	2.5	7.4	3.3	0.3	0.3	2.2
Government Consumption	7.9	2.0	-0.3	-3.2	0.5	7.8	4.9	-1.1	-2.8	-0.2
Total Investment	10.2	2.1	-2.1	-3.5	4.1	12.0	3.4	-1.1	-4.9	3.0
Stocks - pts cont'n to growth	0.5	0.0	-1.2	1.0	0.0	1.4	-0.4	-1.1	0.7	0.2
GNE	7.9	2.5	-1.9	0.0	2.6	10.0	3.4	-1.5	-0.9	2.1
Exports	2.5	6.0	6.5	3.5	5.2	-2.7	-0.2	10.0	3.5	5.3
Imports	17.3	4.3	-1.9	0.9	3.9	14.8	4.6	-0.3	-0.4	3.6
Real Expenditure GDP	4.7	2.8	0.1	0.8	2.8	5.9	2.2	0.6	0.4	2.5
GDP (production)	4.6	2.7	0.1	0.6	2.8	5.6	2.4	0.6	0.2	2.5
<i>GDP - annual % change (q/q)</i>	0.6	2.0	0.0	1.7	3.1	2.6	2.2	-0.3	0.9	3.0
Output Gap (ann avg, % dev)	1.4	1.9	-0.4	-1.2	-0.3	1.5	2.0	0.2	-1.2	-0.5
Nominal Expenditure GDP - \$bn	359	388	410	428	451	353	381	405	422	445
Prices and Employment - annual % change										
CPI	6.9	6.7	4.0	2.6	1.9	5.9	7.2	4.7	2.7	2.0
Employment	2.5	3.0	1.3	0.6	2.5	3.3	1.7	2.7	0.1	2.1
Unemployment Rate %	3.2	3.4	4.3	5.5	5.1	3.2	3.4	4.0	5.3	5.3
Wages - ahote (private sector)	5.3	8.2	4.8	3.9	3.0	4.1	8.1	6.6	3.3	3.0
Productivity (ann av %)	1.8	0.5	-2.4	0.2	1.0	3.6	0.2	-2.3	-0.3	1.1
Unit Labour Costs (ann av %)	4.6	6.5	8.5	3.9	2.2	2.4	6.5	8.8	5.0	2.3
House Prices	13.8	-12.1	2.8	3.0	7.7	27.2	-11.1	-0.7	2.0	6.9
External Balance										
Current Account - \$bn	-23.6	-31.8	-26.9	-21.9	-18.9	-20.6	-33.4	-27.8	-23.9	-20.0
Current Account - % of GDP	-6.6	-8.2	-6.6	-5.1	-4.2	-5.8	-8.8	-6.9	-5.7	-4.5
Government Accounts - June Yr, % of GDP										
OBEGAL (core operating balance)	-2.7	-2.4	-2.7	-3.1	-1.9					
Net Core Crown Debt (ex NZS)	35.5	39.3	43.1	43.5	43.0					
Bond Programme - \$bn (Treasury forecasts)	20.0	28.0	38.0	38.0	36.0					
Bond Programme - % of GDP	5.6	7.2	9.3	8.9	8.0					
Financial Variables ⁽¹⁾										
NZD/USD	0.69	0.62	0.61	0.64	0.66	0.68	0.63	0.62	0.62	0.67
USD/JPY	119	134	150	140	129	114	135	144	143	131
EUR/USD	1.10	1.07	1.09	1.13	1.18	1.13	1.06	1.09	1.11	1.17
NZD/AUD	0.93	0.93	0.93	0.90	0.89	0.95	0.94	0.93	0.90	0.89
NZD/GBP	0.52	0.51	0.48	0.49	0.49	0.51	0.52	0.49	0.48	0.50
NZD/EUR	0.62	0.58	0.56	0.56	0.56	0.60	0.60	0.57	0.56	0.57
NZD/YEN	81.5	83.0	91.1	88.9	85.1	77.4	85.6	89.5	88.7	87.8
TWI	73.9	71.0	71.2	72.4	73.1	73.0	72.9	72.0	71.5	74.0
Overnight Cash Rate (end qtr)	1.00	4.75	5.50	5.25	3.50	0.75	4.25	5.50	5.50	3.75
90-day Bank Bill Rate	1.45	5.16	5.64	5.00	3.25	0.92	4.55	5.63	5.50	3.75
5-year Govt Bond	2.90	4.40	4.60	4.15	3.90	2.20	4.30	4.50	4.25	3.85
10-year Govt Bond	3.20	4.35	4.60	4.60	4.35	2.35	4.25	4.65	4.60	4.35
2-year Swap	3.00	5.15	4.91	3.60	3.35	2.22	5.21	4.93	3.95	3.25
5-year Swap	3.20	4.50	4.40	4.20	4.00	2.56	4.62	4.43	4.30	3.90
US 10-year Bonds	2.10	3.65	4.20	4.00	3.75	1.45	3.60	4.00	4.10	3.75
NZ-US 10-year Spread	1.10	0.70	0.40	0.60	0.60	0.90	0.65	0.65	0.50	0.60

⁽¹⁾ Average for the last month in the quarter

Source: Statistics NZ, BNZ, NZ Treasury

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